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January 6, 2012

**Via Overnight Delivery**

milliman.com

Ms. Sarabeth Snuggs  
State Retirement Director  
Division of Retirement  
1317 Winewood Boulevard, Building 8  
Tallahassee, FL 32399

Re: Study Reflecting the Impact to the Florida Retirement System of  
Members Initially Enrolled on or after July 1, 2012 **Defaulting into Investment Plan**

Dear Sarabeth:

As you requested, we have studied the fiscal impact to the Florida Retirement System of setting the Investment Plan as the default plan election for members initially enrolled on and after July 1, 2012. We have recalculated the uniform or "blended" rates for the 2012-2013 fiscal year based on the required contributions to the Florida Retirement System Defined Benefit and Investment Plans, after reflecting the assumed shift in payroll from the Defined Benefit (DB) Plan to the Investment Plan (IP) as a result of the proposed change.

**Background**

Currently, newly enrolled members have five months during which to make an initial election into the Defined Benefit plan or the Investment Plan. If a member has not made an active election by the end of the fifth month following enrollment, the member defaults into the DB plan. After the period during which a member has the initial choice to elect the DB plan or the IP, the member retains one "second election" opportunity before retirement where the member may, at the member's discretion, choose to move from the initially elected plan into the other plan.

Under the proposal, newly enrolled members would still have five months during which to make an initial election into the DB plan or IP. If the member has not made an active election by the last business day of the 5<sup>th</sup> month following enrollment, the member would default into the IP instead of the DB plan. Also, newly enrolled members would no longer have a "second election" opportunity. Once the initial active or default election occurs, the only "choice of membership" will have expired.

**Methods and Assumptions**

We have discussed with the Division and the State Board of Administration (SBA) statistics reflecting the elections of new enrollees under the current provisions. Currently, approximately 25% of new enrollees make an active election into the IP, 23% make an active election into the DB plan, and the remaining 52% default into the DB plan after making no active election.

Through surveys and polling, the SBA has ascertained that of the 52% who currently default into the DB plan, nearly half ( 45%) allow this default by choice because they want to participate in the DB plan.

Therefore, based on current patterns of new entrant elections, we assumed the following pattern of elections for purposes of the study:

Percentage of New Entrant Elections	Current (DB = default)	Proposed (IP = default)	Comments
25%	IP	IP	Active IP election
23%	DB	DB	Active DB election
23%	DB	DB	Default to DB by choice
29%	DB	IP	True default (no election)

Thus, for purposes of the study, we assumed that 46% of new enrollees (23% + 23%) would enter the DB plan with their initial election and 54% of new enrollees (25% + 29%) would enter the IP with their initial election, if the IP plan were the default instead of the DB plan.

In this study, we recalculated the uniform or "blended" rates for the 2012-2013 fiscal year based on the required contributions to the Florida Retirement System IP and DB plans, after reflecting the increase in IP payroll as a result of the proposed changes. The assumptions above of 46% and 54% reflect the proportion of members by count. The actual elections will determine the actual DB versus IP payroll allocation.

At this point, we feel there is not evidence one way or another on which to base or modify an assumption regarding the elimination of the "second election". Therefore, our analysis assumes no impact due to the elimination of the "second election" option.

We used demographic and economic assumptions consistent with those used in the July 1, 2011 valuation, modified as discussed above. The study projected the change in uniform blended rates for the 2012-2013 fiscal year.

## Results

Table I shows the results of our study based on actual levels of participation in the IP and DB plans as of July 1, 2011, adjusted to reflect an expected increase in IP participation. The results of the table are based on an assumption that the IP payroll will increase during fiscal year 2011-2012 (due to salary inflation and membership growth) at the same rate that it increased during fiscal year 2010-2011, plus 54% of new enrollees are assumed to enter the IP (as opposed to 25% assumed currently). Thus, in total, the projected July 1, 2012 IP payroll is approximately 15.4% greater than the IP payroll as of July 1, 2011. The projected IP payroll comprises approximately 15.9% of total payroll in fiscal year 2011-2012, as compared with 13.3% in fiscal year 2010-2011.

Section A includes the normal cost as of July 1, 2011 of the Defined Benefit Plan. Section A does not include the UAL cost because such contribution rates are applied to a larger total payroll. Section A, line 3 shows the total employer normal cost of the DB plan as the product of

normal cost contribution rates and projected normal cost payroll.

Similarly, Section B calculates the total employer cost of the Investment Plan as the product of applicable employer contribution rates and projected IP payroll. IP payroll is projected to mimic the fiscal year 2010-2011 increase, and includes a larger proportion of new enrollee payroll, as described above.

Section C of the table shows the sum of the DB normal cost and Investment Plan cost as dollars and as a percentage of total payroll (DB projected normal cost payroll plus IP projected payroll).

Section D of the table shows the UAL cost as of July 1, 2011 of the Defined Benefit Plan. However, the UAL cost rates are slightly different from those in Table IV-4 of the July 1, 2011 valuation report. This is because total payroll (DB plus IP) has been projected forward one year using the valuation salary inflation assumption of 4.0% for determining blended rates. The IP payroll is projected individually by membership class to increase as described above. DB projected payroll is equal to the total projected payroll less the IP projected payroll. Thus, though the IP payroll and DB payroll in total increase by 4.0%, there are variations in the increase by membership class. As a result, the UAL cost rates shown in Table I (line (D1)(b)) may be a larger or smaller percent of payroll based on whether the IP plan payroll for that particular membership class grew in excess of or less than 4.0% during fiscal year 2010-2011. The projected payroll in line (D2) is greater than the projected payroll in line (A2) because it includes the salaries of members subject to only the UAL contribution rate.

Section E shows there is no UAL cost attributable to the Investment Plan.

Section F calculates the "Blended" UAL cost as dollars and as a percentage of total payroll (DB projected UAL payroll plus IP projected payroll).

Section G shows the final Blended Uniform Contribution Rates as the sum of the "Blended" Normal Cost Contribution Rates from Line (C3) and the "Blended" UAL Contribution Rates from Line (F3). The employers of employee groups subject to only the UAL contribution rate will pay the "Blended" UAL Contribution Rates shown in Line (G2) of the table. The Total Adjusted Contribution Rates shown in Line (G3) of the table will be paid on all other salaries.

Section H shows the final Blended Uniform Contribution Rates developed in the July 1, 2011 valuation. These rates come directly from Section G of the Blended Rate Study dated November 30, 2011 prepared in conjunction with the July 1, 2011 actuarial valuation.

Section I shows the increase (or decrease) in the Blended Uniform Contribution Rates of the studied proposal over the rates determined by the July 1, 2011 valuation.

The contribution rates shown in the table exclude the 0.03% contribution rate for IP administration and education (applied to all classes except DROP) and the 1.11% contribution rate for the health insurance subsidy (HIS), which apply across the board to the IP and DB plans.

Under current law, the blended rates reflect a payroll allocation of about 85% DB and 15% IP. Based on current election trends, we would expect the IP payroll to approach a 20% to 25% allocation, and the DB payroll to be proportionately reduced to 80% to 75%. Under this proposal the current DB/IP payroll allocation for fiscal year 2012-2013 only changes modestly. However, longer term we would expect the IP payroll to approach and slightly exceed 50% of the total FRS payroll. The payroll splits are the basis for the weighting of the DB and IP contribution rates used to develop the blended rates.

① The trends and/or law change leading to a greater IP participation rate may also affect the DB UAL contribution rate in at least two ways. First, because fewer members would be enrolling in the DB plan, future measurements of the actuarial liability will be less than expected under  
② current law. Second the DB payroll will grow more slowly meaning our current assumption of an annual 4% increase in the total DB payroll may have to be reduced. This would result in larger amortization payments in the short-term but lower in the out years since the DB payroll will be assumed to grow more slowly. Note in this study the blended UAL rate is reduced because more payroll is being allocated to the IP plan and the DB UAL contribution rate was not adjusted upward to reflect this fact.

The calculations are based on data provided to us by the Division of Retirement for the July 1, 2011 actuarial valuation. We have not audited or verified this data and other information. If the underlying data or information is inaccurate or incomplete, the results of our analysis may likewise be inaccurate or incomplete. These calculations are based on the standard entry age actuarial cost method.

We performed a limited review of the data used directly in our analysis for reasonableness and consistency and have not found material defects in the data. If there are material defects in the data, it is possible that they would be uncovered by a detailed, systematic review and comparison of the data to search for data values that are questionable or for relationships that are materially inconsistent. Such a review was beyond the scope of our assignment.

This analysis is based on the July 1, 2011 actuarial valuation methods and assumptions. The data was based on the July 1, 2011 FRS actuarial valuation database. The results of our study depend on future experience conforming to those actuarial assumptions discussed earlier in this letter. Future actuarial measurements may differ significantly from the current measurements presented in this report due to many factors, including: plan experience differing from that anticipated by the economic or demographic assumptions; changes in economic or demographic assumptions; increases or decreases expected as part of the natural operation of the methodology used for these measurements (such as the end of an amortization period) and changes in plan provisions or applicable law. Due to the limited scope of our assignment, we did not perform an analysis of the potential range of future measurements. In addition, the cost/(savings) of the proposed change will depend on the actual legislation.

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The consultants who worked on this assignment are pension actuaries. Milliman's advice is not intended to be a substitute for qualified legal or accounting counsel.

I, Robert Dezube, am a consulting actuary, for Milliman, Inc. We are also members of the American Academy of Actuaries, and meet their Qualification Standards to render the actuarial opinion contained herein.

Please call if you would like to further discuss this project.

Sincerely,

Milliman, Inc.

A handwritten signature in cursive script that reads "Kathryn M. Hunter".

Kathryn M. Hunter, ASA  
Associate Actuary

A handwritten signature in cursive script that reads "Robert S. Dezube".

Robert S. Dezube, FSA  
Consulting Actuary

Enclosures

FLORIDA RETIREMENT SYSTEM  
FISCAL IMPACT ANALYSIS

Blended Normal Cost Plus UAL Rates for 2012-2013 Fiscal Year  
Assuming Investment Plan Becomes FRS Default Plan Effective July 1, 2012  
(000 omitted)

	FRS Regular	Special Risk		Elected Officers' Class		Senior Management	Composite (excluding DROP)	DROP	Composite (including DROP)
		Regular	Administration	Judicial	Leg-Atty-Cab County				
<b>A. Defined Benefit Plan Normal Cost</b>									
1. Employer Cost									
a. Normal Cost Rate <sup>1</sup>	3.54%	10.74%	3.43%	9.93%	6.38%	8.20%	4.80%	4.33%	4.64%
b. Rate Reduction Techniques	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
c. Total Adjusted Contribution Rate <sup>3</sup> -FY 2013	3.54%	10.74%	3.43%	9.93%	6.38%	8.20%	4.80%	4.33%	4.64%
2. Projected Payroll	\$19,279,846	\$3,488,849	\$2,241	\$102,008	\$6,167	\$42,672	\$480,327	\$2,802,529	\$26,204,639
3. Total Employer Normal Cost [(1c) x (2)] -FY 2013	\$682,507	\$374,702	\$77	\$10,129	\$393	\$3,499	\$23,056	\$121,350	\$1,215,713
<b>B. Defined Contribution Plan Cost (Normal Cost)</b>									
1. Employer Rates effective July 1, 2002 (Sec 121.72)	6.25%	18.33%	8.80%	16.63%	10.81%	13.61%	8.21%	0.00%	8.14%
2. Projected Payroll	\$4,013,279	\$747,196	\$799	\$9,495	\$2,414	\$17,087	\$161,793	\$0	\$4,952,063
3. Total Employer Cost [(1) x (2)] -FY 2013	\$250,830	\$136,961	\$70	\$1,579	\$261	\$2,326	\$13,283	\$0	\$405,310
<b>C. Total System Normal Cost (DB Plan + DC Plan)</b>									
1. Total Normal Cost Contribution [(A3) + (B3)]	\$933,337	\$511,663	\$147	\$11,708	\$654	\$5,825	\$36,339	\$121,350	\$1,621,023
2. Total System Projected Payroll [(A2) + (B2)]	\$23,293,125	\$4,236,045	\$3,040	\$111,503	\$8,581	\$59,759	\$642,120	\$2,802,529	\$31,156,702
3. "Blended" Normal Cost Contribution Rate As a Percentage of Total Payroll [(C1) / (C2)] <sup>3</sup>	4.01%	12.08%	4.84%	10.50%	7.62%	9.75%	5.66%	4.33%	5.20%

<sup>1</sup> As reported in the July 1, 2011 valuation - Table IV-4

<sup>2</sup> Composite rates are based on 2011 payroll instead of the projected payroll.

<sup>3</sup> Rates shown do not include the HIS contribution rate or IP administrative fees.

This work product was prepared solely for the Department of Management Services for the purposes described herein and may not be appropriate to use for other purposes. Milliman does not intend to benefit and assumes no duty or liability to other parties who receive this work.

**FLORIDA RETIREMENT SYSTEM**  
FISCAL IMPACT ANALYSIS

*Blended Normal Cost Plus UAL Rates for 2012-2013 Fiscal Year  
Assuming Investment Plan Becomes FRS Default Plan Effective July 1, 2012  
(000 omitted)*

UAL

	FRS Regular	Special Risk		Elected Officers' Class		Senior Management	Composite (excluding DROP)	DROP	Composite (including DROP)
		Regular	Administration	Judicial	Leg-Atty-Cab County				
<b>D. Defined Benefit Plan UAL Cost</b>									
1. Employer Cost	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
a. Normal Cost Rate	2.37%	8.43%	36.68%	17.81%	37.41%	14.86%	3.58%	6.21%	3.85%
b. UAL Cost									
c. Total Adjusted Contribution Rate <sup>3</sup>									
-FY 2013	2.37%	8.43%	36.68%	17.81%	37.41%	14.86%	3.58%	6.21%	3.85%
2. Projected Payroll	\$21,004,214	\$3,490,534	\$2,241	\$102,082	\$6,188	\$42,854	\$25,145,763	\$2,802,529	\$27,948,292
3. Total Employer UAL Cost [(1c) x (2)]	\$497,800	\$294,252	\$822	\$18,181	\$2,315	\$13,876	\$901,197	\$174,037	\$1,075,234
<b>E. Defined Contribution Plan Cost (UAL)</b>									
1. Employer Rates effective July 1, 2002 (Sec 121.72)	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
2. Projected Payroll	\$4,013,279	\$747,196	\$799	\$9,495	\$2,414	\$17,087	\$4,952,063	\$0	\$4,952,063
3. Total Employer Cost [(1) x (2)]	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
<b>F. Total System UAL Cost (DB Plan + DC Plan)</b>									
1. Total UAL Contribution [(D3) + (E3)]	\$497,800	\$294,252	\$822	\$18,181	\$2,315	\$13,876	\$901,197	\$174,037	\$1,075,234
2. Total System Projected Payroll [(D2) + (E2)]	\$25,017,493	\$4,237,730	\$3,040	\$111,577	\$8,602	\$59,941	\$30,097,826	\$2,802,529	\$32,900,355
3. "Blended" UAL Contribution Rate As a Percentage of Total Payroll [(F1) / (F2)] <sup>3</sup>	1.99%	6.94%	27.04%	16.29%	26.91%	23.15%	2.99%	6.21%	3.27%

<sup>2</sup> Composite rates are based on 2011 payroll instead of the projected payroll.

<sup>3</sup> Rates shown do not include the HIS contribution rate or IP administrative fees.

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**FLORIDA RETIREMENT SYSTEM**  
FISCAL IMPACT ANALYSIS

**Blended Normal Cost Plus UAL Rates for 2012-2013 Fiscal Year**  
**Assuming Investment Plan Becomes FRS Default Plan Effective July 1, 2012**  
(000 omitted)

	FRS Regular	Special Risk		Judicial	Elected Officers' Class		Senior Management	Composite (excluding DROP)	DROP	Composite (including DROP)
		Regular	Administration		Leg-Atty-Cab	County				
<b>Blended Uniform Contribution Rates<sup>4</sup></b>										
<b>G: Total Employer Contribution Rate (DB Plan + DC Plan)</b>										
1. "Blended" Normal Cost Contribution Rate [(C3)]	4.01%	12.08%	4.84%	10.50%	7.62%	9.75%	5.66%	5.29%	4.33%	5.20%
2. "Blended" UAL Contribution Rates [(F3)]	1.99%	6.94%	27.04%	16.29%	26.91%	23.15%	11.21%	2.99%	6.21%	3.27%
3. Total Adjusted Contribution Rate <sup>3</sup> -FY 2013 [(G1) + (G2)]	6.00%	19.02%	31.88%	26.79%	34.53%	32.90%	16.87%	8.28%	10.54%	8.47%
<b>H: Total Employer Contribution Rate (DB Plan + DC Plan)</b> <b>As Determined in July 1, 2011 Valuation Blended Rate Study</b>										
1. "Blended" Normal Cost Contribution Rate	3.97%	12.00%	4.84%	10.47%	7.59%	9.77%	5.65%	5.25%	4.33%	5.17%
2. "Blended" UAL Contribution Rates	2.02%	7.03%	27.04%	16.38%	27.18%	23.01%	11.25%	3.03%	6.21%	3.30%
3. Total Adjusted Contribution Rate <sup>3</sup> -FY 2012 [(H1) + (H2)]	5.99%	19.03%	31.88%	26.85%	34.77%	32.78%	16.90%	8.28%	10.54%	8.47%
<b>I: Increase / (Decrease) in Valuation Total Employer Contribution Rate Due to Proposal</b>										
1. "Blended" Normal Cost Contribution Rate [(G1) - (H1)]	0.04%	0.08%	0.00%	0.03%	0.03%	-0.02%	0.01%	0.04%	0.00%	0.03%
2. "Blended" UAL Contribution Rates [(G2) - (H2)]	-0.03%	-0.09%	0.00%	-0.09%	-0.27%	0.14%	-0.04%	-0.04%	0.00%	-0.03%
3. Total Adjusted Contribution Rate <sup>3</sup> -FY 2012 [(I1) + (I2)]	0.01%	-0.01%	0.00%	-0.06%	-0.24%	0.12%	-0.03%	0.00%	0.00%	0.00%

<sup>3</sup> Rates shown do not include the HIS contribution rate or IP administrative fees.

<sup>4</sup> Employers of employee groups subject to only the UAL contribution rate will pay the rates shown in line (G2).

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